The Manufacturers Hanover
# Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, DECEMBER 14, 1981 VOLUME XVIII, NUMBER 50

B 1350-2

## For Corporate Profits . . .

One of the more significant problems affecting the credit markets has been the lackluster growth of corporate earnings. The inability of U.S. corporations to generate strong earnings growth in light of the twin challenges of slumping productivity and escalating costs almost ensures that internally generated funds will continue to fall far short of capital requirements. And when you consider that the quality of after-tax earnings has exhibited little improvement, as corporations continue to post sizable gains in inventory profits and run inadequate depreciation allowances, a rather sizable financing gap emerges which must be bridged by external borrowings.

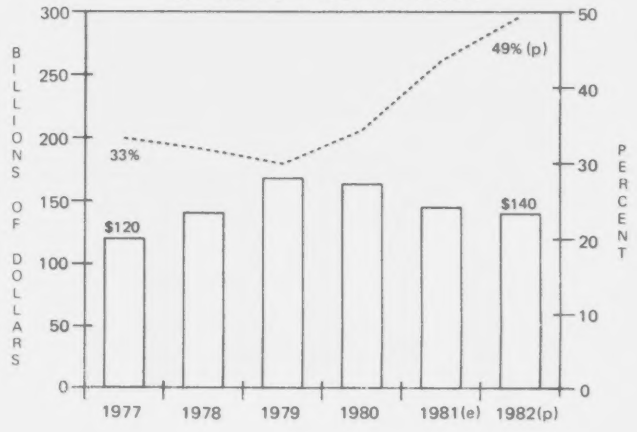
In the third quarter, before-tax book profits increased at a seasonally adjusted $1.9 billion annual rate, quarter-over-quarter, to $230.9 billion. This was an improvement compared with the extremely dismal second quarter performance. At that time, corporate earnings skidded at a $28 billion annual rate quarter-over-quarter, one of the steepest three-month slides ever. After-tax earnings also rebounded slightly, eking out an approximately $1 billion annual rate gain to $153.5 billion, following a more than $16 billion drop in the second quarter. Of this total, corporations reported retained earnings of about $89 billion, not far from the previous quarter's levels.

Unfortunately, what seems to be a better profits performance masks the still serious erosion of earnings quality due to inflation. The ongoing rise in prices, for example, continues to increase the value of inventories held in stock. As a result, inventory profits advanced at an almost $30 billion seasonally adjusted annual rate in the third quarter, a gain of about ten per cent compared with the prior quarter's levels—comprising about one-third of all retained earnings. To the extent that the proportion of retained earnings accounted for by temporary inventory profits increased during the quarter (from about 25 per cent in the second quarter), the quality of reported earnings, as opposed to their size, decreased.

## . . . It's Worse Than You Think . . .

Nor are inventory profits the only factor distorting corporate earnings. Since depreciation schedules are based on historical rather than replacement costs, it is hardly surprising that capital consumption allowances fall far short of replacement costs during periods of rapid price inflation. This shortfall totaled more than $13 billion in the third quarter (expressed at a seasonally adjusted annual rate), equal to approximately 20 per cent of retained earnings. Adjusting retained earnings for both inventory profits and replacement cost depreciation reduces reported undistributed profits from $89 billion to less than $50 billion, an almost $40 billion—or 45 per cent—reduction.

AFTER-TAX CORPORATE PROFITS (BAR)
VS. DIVIDEND PAYOUT RATIO (DOT)




Despite this lackluster growth in earnings—not to mention their "soft" quality—dividend payments have surged to new record highs. Cash distributions probably reached almost $65 billion in 1981, $9 billion more than the year before and about $15 billion higher than in 1979—a year in which after-tax profits were about $20 billion greater than now. As a result, the dividend payout ratio, which compares dividends and after-tax corporate profits, should exceed 41 per cent in 1981, its highest level since 1971.

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What is more, if the economy continues to weaken, corporate earnings will once again diminish. And since corporations tend to be extremely reluctant to slash dividends, this development could push the dividend payout ratio to even loftier heights—placing a heavy strain on corporate balance sheets. Clearly, this would lead to greater credit demands in the months ahead.

### . . . The Same For Capital Spending

Aside from the potential impact on the credit markets, the deterioration in corporate profits could affect business spending on new plant and equipment. Despite the investment incentives given to business by the Administration on October 1 as a part of its economic recovery program, many industries have begun to scale down their capital spending plans. Corporations, it seems, are responding more to the sluggish pace of economic activity. Most importantly, they are looking at the recent sharp declines in industrial production and capacity utilization, as opposed to the beneficial impact of the new tax policies.

A Conference Board survey of the nation's 1,000 largest manufacturers showed that capital appropriations—authorizations to spend money in the future which precede the actual ordering

## Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

| | Week Ending 12/2/81 | $ Change Since Week Ago | $ Change Since Year Ago |
|---|---|---|---|
| Reserve Bank Credit | | | |
| U.S. Gov'ts and Agencies Owned Outright & RPs | 135.471 | + .027 | + 7.368 |
| Loans to Depository Inst. | .317 | – .020 | – 1.825 |
| Float | 4.032 | + .539 | – 1.529 |
| Total Reserve Bank Credit | 150.120 | + .801 | + 7.563 |
| Treasury Deposits with Federal Reserve Banks | 3.028 | + .187 | + .183 |
| Currency Outside Banks | 126.441 | – .188 | + 5.338 |
| Member Bank Reserves: | | | |
| Required | 41.230 | + .477 | + 1.320 |
| Excess (Deficiency) | .218 | – .008 | – .663 |
| Total Reserves Held | 41.448 | + .469 | + .657 |
| Net Borrowed Reserves | .058 | + .016 | – 1.093 |
| Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week) | 96.054 | + 2.055 | + 5.492 |

| Monetary Aggregates† | | % Change Since Three Months Ago* | % Change Since Year Ago |
|---|---|---|---|
| M1-B | 439.9 | + 4.4‡ | + 4.2‡ |
| M2 (November '81) | 1,823.0 | + 10.3 | + 9.3 |
| M3 (November '81) | 2,165.6 | + 9.1 | + 11.0 |
| L (August '81) | 2,552.3 | + 11.6 | + 11.4 |

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

## New York Money Market

| Offering Rates 12/11/81 | 3 Months | 6 Months | 1 Year |
|---|---|---|---|
| ‡U.S. Treasury Bills | 10.55% | 11.25% | 11.25% |
| * Federal Agencies | 11.30 | 11.80 | 12.25 |
| * Project Notes—Taxfree (46% Taxable Equivalent) | 11.85 | 12.31 | NA |
| Negotiable Time CDs Manufacturers Hanover | Rates By Arrangement | | |
| * Secondary Market—Prime | 12.60 | 13.15 | 14.00 |

| ‡Finance Company Paper—Prime | | ‡* Bankers' Acceptances | |
|---|---|---|---|
| 5- 14 days | 12.13% | Jan. | 12.00% |
| 15- 29 days | 12.13 | Feb. | 12.00 |
| 30- 59 days | 12.13 | Mar. | 12.20 |
| 60- 89 days | 10.88 | Apr. | 12.30 |
| 90-179 days | 10.88 | May | 12.30 |
| 180-239 days | 10.88 | Jun. | 12.20 |
| 240-270 days | 10.50 | | |

| ‡Industrial Paper—Prime | | | |
|---|---|---|---|
| 30- 89 days | 11.88% | †Federal Funds Effective Rate | 12.25% |
| 90-120 days | 11.88 | | |

‡Discount basis. * Subject to availability. † Estimated.

## Selected Business Indicators

(All Dollar Figures in Billions)

| | Latest Period or End of Period | | Previous Period | Year Ago Period |
|---|---|---|---|---|
| Gross National Product (Current Dollars)* | 3rd Q'81 | $ 2,957 | $ 2,886 | $ 2,637 |
| Gross National Product (1972 Dollars)* | 3rd Q'81 | $ 1,513 | $ 1,510 | $ 1,472 |
| Percent Change, Annual Rate | 3rd Q'81 | 0.6 | – 1.6 | 2.4 |
| Change in Consumer Prices (all urban consumers)* | Oct '81 | 4.8% | 14.4% | 12.0% |
| Change in Producer Prices* | Nov '81n | 6.0% | 7.2% | 8.4% |
| Civilian Employment (Thousands of Persons)† | Nov '81 | 98,025 | 98,217 | 97,339 |
| Unemployment as % of Civilian Labor Force† | Nov '81 | 8.4% | 8.0% | 7.5% |
| Personal Income* | Oct '81 | $ 2,477 | $ 2,462 | $ 2,234 |
| Leading Indicators Composite Index (1967=100)† | Oct '81 | 128.1 | 130.4 | 135.0 |
| Industrial Production Index (1967=100)† | Oct '81 | 149.5 | 151.8 | 146.6 |
| Net Change in Consumer Installment Credit† | Oct '81n | $ 1.01 | $ 2.82 | $ 0.70 |
| U.S. Merchandise Trade Balance† | Oct '81 | –$ 4.19 | –$ 1.57 | –$ 1.13 |
| Plant and Equipment Expenditures* | 1st Q'82n | $345.46(a) | $332.69(a) | $312.24 |
| Private Housing Starts (Thousands of Units)* | Oct '81 | 857 | 920 | 1,519 |
| New Construction Expenditures* | Oct '81 | $ 230.8 | $ 234.7 | $ 228.9 |
| Total Business Inventories† | Sept '81 | $ 507.2 | $ 502.5 | $ 471.5 |
| Total Business Sales† | Sept '81 | $ 354.2 | $ 352.8 | $ 327.8 |

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

of equipment or the negotiation of construction contracts—fell by 5.6 per cent in the third quarter from the previous quarter's level. This decline followed three consecutive quarterly increases. Not surprisingly, machine tool orders, a good advance indicator of investment trends, have dropped sharply. During the last three months, they plunged 16 per cent from the previous three-month average and are currently running 35 per cent below last year. Orders for nondefense capital goods in the last three months were 3.2 per cent below the previous three-month period, while private construction put in place (without adjusting for inflation) declined by about 1.5 per cent during the two months ending in October.

The Commerce Department has just confirmed that businessmen are trimming their plans to invest. According to its quarterly survey of capital spending outlays and plans, businessmen project their fourth-quarter 1981 outlays to be $332.06 billion, down from the $333.09 billion they expected six months ago. What is more, actual spending is likely to be even lower than currently projected, because of the sharp slide in economic activity since the survey was taken. ■

## Short Term Paper Outstanding

(Millions of Dollars)

| | Latest Week | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| **Negotiable Time CD's Weekly Reporting Banks** | | | |
| Nationwide (11/25/81) | 132,640 | + 3,296 | +25,295 |
| New York City (11/25/81) | 33,134 | + 1,965 | + 6,297 |
| **Commercial Paper** (11/25/81) | 166,614 | – 1,026 | +42,529 |

## Bank Loans

(Millions of Dollars)

**Commercial and Industrial Loans**

| Weekly Reporting Large Commercial Banks | Latest Week | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| Nationwide (11/25/81) | 190,021 | + 383 | +18,236 |
| New York City (11/25/81) | 55,032 | + 65 | + 4,614 |

**Total Loans Gross Adjusted**

| | Latest Week | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| Nationwide (11/25/81) | 464,650 | + 3,086 | +43,196 |
| New York City (11/25/81) | 111,921 | + 2,676 | +13,855 |

## Financial Markets

| | Friday 12/11/81 | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| **U.S. Governments, Closing Yields:** | | | |
| 90-Day Bills† | 11.20% | + .88 | – 6.25 |
| 180-Day Bills† | 12.20 | + 1.21 | – 4.54 |
| Longest Bills† | 12.60 | + 1.07 | – 2.70 |
| **Recent Issues:** | | | |
| 12 1/8s 11/30/83 | 13.25 | + 1.12 | |
| 15 7/8s 9/30/85 | 14.00 | + .92 | |
| 14 1/4s 11/15/91 | 13.75 | + .65 | |
| 14s 11/15/11 | 13.45 | + .56 | |
| **Municipals:** | | | |
| Bond Buyer–20 Bond Index* (12/10/81) | 12.89% | + .71 | + 2.47 |
| Blue List Total ($ Million) | $1,459 | + $208 | + $ 571 |
| 30-Day Visible Supply ($ Million) | $2,428 | + $259 | – $ 493 |
| Total | $3,887 | + $467 | + $ 78 |
| **Corporates:** | | | |
| Moody's Aa Composite (12/10/81) | 14.84% | + .16 | + .59 |
| 30-Day Visible Supply ($ Million) | $9,257 | –$1,370 | + $5,794 |
| **Stocks:** | | | |
| **Dow-Jones Averages:** | | | |
| Industrials | 886.51 | – 6.18 | – 30.64 |
| Transportation | 391.11 | – 3.92 | + 9.87 |
| Utilities | 111.98 | – .94 | + .51 |
| 65 Stocks | 354.83 | – 2.90 | – 2.46 |
| **Standard and Poor's 500 Stocks** | 124.93 | – 1.33 | – 4.3 |
| **N.Y.S.E. Composite Index** | 72.43 | – .81 | – 1.73 |
| **N.Y.S.E. Avg. Daily Vol. for Week (000's)** | 45,788 | – 3,254 | – 9,713 |

* 46% Taxable equivalent 23.87%.

† Bond equivalent.

## International Rates

| EURODOLLAR DEPOSIT RATES (bid) | Friday 12/11/81 | Week Ago |
|---|---|---|
| Overnight | 12.13% | 11.75% |
| 1 month | 13.19 | 12.38 |
| 3 month | 13.50 | 12.50 |
| 6 month | 14.00 | 12.81 |
| 1 year | 14.25 | 13.38 |
| **EURODOLLAR BONDS** | | |
| **Average Yield** | | |
| Medium Term (5 to 7 yrs.) | 14.55% | 14.25% |
| Long Term (7 to 15 yrs.) | 15.10 | 14.90 |

**FOREIGN EXCHANGE SPOT RATES**

| New York Opening (12/11/81) | U.S. $ Equivalent | Currency Per U.S. $ |
|---|---|---|
| Belgium | .02593 | 38.57 |
| Canada | .8427 | 1.1867 |
| Denmark | .1364 | 7.3303 |
| France | .1746 | 5.7265 |
| Germany | .4437 | 2.2540 |
| Italy | .0008270 | 1209.20 |
| Japan | .004575 | 218.60 |
| Mexico | .03848 | 25.99 |
| Netherlands | .4045 | 2.4720 |
| Switzerland | .5425 | 1.8433 |
| U.K. | 1.8808 | .5317 |

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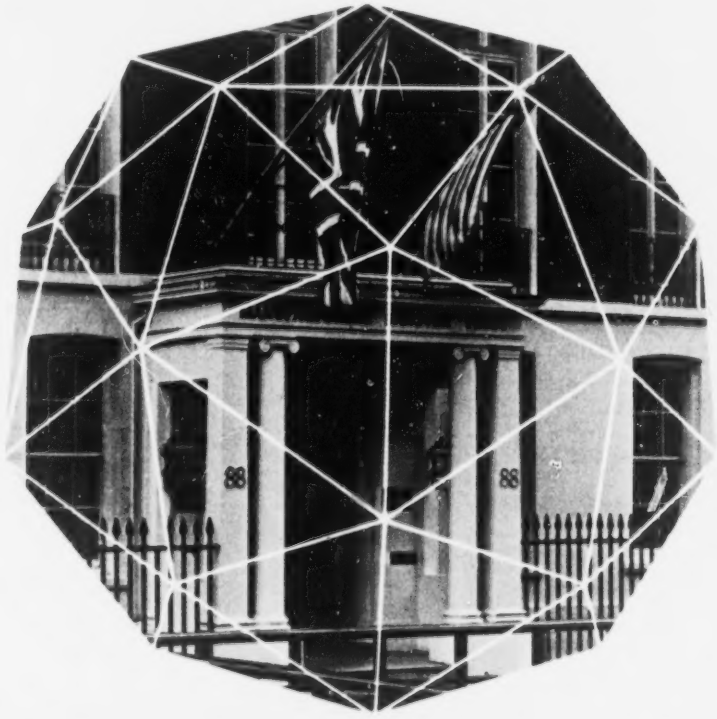

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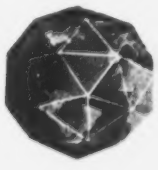

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